

Thank God It's Friday!

June 15, 2007

Inflation is like the Tale of Two Cities: tame on Wall Street but vicious on Main Street. Inflation continues to be kept at bay, at least that's what most economists will tell you. The core Consumer Price Index (CPI) climbed 0.1% in May but that doesn't count what you and I pay on a regular basis. If the CPI included **food and energy prices**, the number would be considerably higher. The price of **wheat** is at an 11 year high, and we don't need to tell you where **energy** prices are. As you know, the Consumer makes up 2/3 of our economy. We depend on *her* discretionary spending to keep us chugging along. If those discretionary dollars are soaked up at the gas pump, it neutralizes her buying power.

For the last few years, we have been **importing deflation from China, India** and other emerging markets. Products and services can be provided cheaper over there, which lowers the prices that we pay at the store. Clothes, shoes, computers, cars and TV's have all come down in price over the last year. This is an important point that can't be ignored, and is potentially at risk if Congress wants to stamp tariffs to help balance out our trade deficits. The American consumer would be the ultimate loser on that front.

While some prices are dropping, pain is being felt in other industries. **Education costs** are skyrocketing. College tuition is increased 9% over the past 3 years and Findaid.org which studies trends in higher education costs, says "it would be reasonable to expect an average college inflation rate of 7% or 8% per year for the next ten years." Ouch! As for **health care**, an indication of inflation in this big ticket necessity is the Medicare Premium withheld from seniors' Social Security check, which has increased by at an average annual rate of **11.6%** since 2002 while the Cost of Living increase for Social Security since 2002 has averaged just **2.7%** per year. Congress is considering the use of a "CPI-Elderly" index to calculate Social Security cost-of-living increases. This would better reflect the increased health care expense incurred by seniors. They have addressed this several times before with no relief for seniors so far.

The Federal Reserve watches the core CPI very closely when making monetary policy decisions. Why do they base these decisions on "core CPI," **which excludes food and energy**, when clearly Americans do eat, drive and occasionally turn on our air conditioners? This is because food and energy prices can be extremely volatile from month to month due to temporary supply disruptions related to weather or to political events. Since the Fed's policies are more long-term in nature it would be counterproductive for them to try to address price gyrations that are likely temporary. Historically, core and headline inflation average the same over the long run. However, an interesting dichotomy has popped up in recent months. Since last October, "headline" inflation has been rising, while "core" inflation has been creeping down.

Fortunately, the Fed has made very clear their commitment to keeping inflation under control and so far, Bernanke & Co. have done a good job, while they economy has kept humming at a respectable albeit subdued pace. We expect this to continue.
By: Nancy Tredwell, Melanie Hoopes and Mike Frazier

INDEX	06.15.2007	12.31.2006	%Change
DOW	13,639	12,463	+9.4%
S&P 500	1,533	1,418	+8.1%
NASDAQ	2,627	2,415	+8.8%
Bond %	5.17%	4.71%	+9.8%*

Bond Prices



Bond Yield %

